

## 2010 FTA Revenue Estimation & Tax Research Conference

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### *Tax Reform in Rhode Island: A Long and Winding Road*



Paul L. Dion, Ph.D.  
Chief, Office of Revenue Analysis  
Rhode Island Department of Revenue  
(401) 574-8943 pdion@revenue.ri.gov

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- The Case for Tax Reform in Rhode Island
- The Earlier Tax Reform Efforts in Rhode Island
- Governor's Tax Policy Strategy Workgroup
- The Personal Income Tax Reform of 2010

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# The Case for Tax Reform in Rhode Island

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## Rhode Island Has Fared Poorly in National Rankings

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- ❑ Tax Foundation's State Business Tax Climate Index FY 2010: 44<sup>th</sup>
- ❑ CNBC's America's Top States for Business 2010: 49<sup>th</sup>
- ❑ Forbes' Best States for Business 2009: 50<sup>th</sup>
- ❑ In all of these rankings, Rhode Island had the lowest rank of all the New England states

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# Earlier Tax Reform Efforts in Rhode Island

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## Personal Income Tax Reforms

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- In 1997, the phase-in over five years of a 10.0 percent reduction in RI's marginal income tax rates was enacted, reducing the top marginal rate from 10.89 to 9.90 percent by tax year 2002
- In 2002, effective for tax year 2007, a 67.0 percent reduction in the tax rate for realized capital gains from the sale of assets held more than five years was enacted, reducing the top capital gains tax rate from 5.0 to 1.67 percent

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## Personal Income Tax Reforms

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- In 2005, the alternative flat rate income tax system was passed into law allowing taxpayers the option of filing their income taxes using a simplified flat rate system
- Taxpayers could file under the traditional income tax system with its deductions, exemptions, credits and progressive rates or they could pay a flat rate of tax on their modified adjusted gross income with no deductions or exemptions and very limited credits
- The alternative flat rate income tax system had a phase-in of reduced flat rates over time, beginning at 8.0 percent in TY 2006 and declining in one-half percent increments until it reached 5.5 percent in TY 2011

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### **Governor's Tax Policy Strategy Workgroup**

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## The Workgroup's Objective and Composition

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- ❑ Formed by Governor Carcieri in May 2008 with the following objective:

*"Develop a tax strategy so that Rhode Island's tax structure is a competitive advantage in retaining jobs and recruiting businesses"*

- ❑ Twenty-one member group consisting of accountants and attorneys who specialize in tax matters, financial planners, economists, business and labor leaders, the Executive Director of the Rhode Island Economic Development Corporation, and the Director of the Department of Revenue but no Legislative Branch invitees would participate

## The Workgroup's Focus Was on Broad Based Tax Reform

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- ❑ The Workgroup focused on three areas: individual taxes, business taxes and property taxes
- ❑ The individual taxes subgroup considered personal income taxes, sales and use taxes, and the estate tax
- ❑ The business taxes subgroup considered the corporate income tax and the taxation of pass through entities
- ❑ The property taxes subgroup considered the property tax capacity of local governments

## The Workgroup's Proposals: Personal Income Tax

- Reduce the number of income tax brackets from five to four with lower marginal rates

Taxable Income Bracket	Tax Rate
\$0 to \$54,999	3.50%
\$55,000 to \$109,999	4.00%
\$110,000 to \$174,999	4.50%
\$175,000 and more	5.50%

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## The Workgroup's Proposals: Personal Income Tax

- Eliminate itemized deductions in favor of large combined standard deduction and exemption amount

Filing Status	Standard Deduction Amount
Married Joint / Widow(er)	\$15,000
Single / Married Separate	\$7,500
Head of Household	\$11,250

Exemption Type	Exemption Amount
Personal	\$2,500
Dependent	\$2,500

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## The Workgroup's Proposals: Personal Income Tax

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- Allow for five credits against tax: a fully refundable Earned Income Tax Credit at 15.0 percent of federal EITC; a Property Tax Relief Credit; a Lead Paint Abatement Credit; a Credit for Contributions to Scholarship Organizations; and a Credit for Income Taxes Paid to Other States
  
- Eliminate the preferential tax treatment of all capital gains. The proposed system taxes capital gains at ordinary income tax rates

## The Workgroup's Proposals: Sales and Use Tax

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- Expansion of the state's sales tax base must be accompanied by a reduction in Rhode Island's sales and use tax rate
  
- A thorough assessment of the impact of such an expansion on small business, particularly those located in border communities, should be undertaken

## The Workgroup's Proposals: Estate and Transfer Tax

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- Increase the amount of gross taxable estate value exempt from the tax immediately from \$675,000 to \$1,000,000
- Gradually increase the exemption amount to \$3.5 million, the 2009 federal estate tax exemption
- Effective for decedents whose death occurs after December 31, 2009

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## The Workgroup's Proposals: Corporate Income Tax

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- Eliminate the Corporate Income Tax over a five year period and replace the corporate minimum tax with a tiered system according to corporations' net income in Tax Year 2014
- Make the eligible employee requirement for the Jobs Development Act rate reduction be full-time employees with benefits and a minimum salary of 250 percent of the hourly Rhode Island minimum wage
- Restructure the tax appeals process through the creation of a "Tax Calendar" in Superior Court and eliminate the requirement that the tax assessment under appeal be paid in full prior to the appeal being heard

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## The Workgroup's Proposals: Property Tax

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- Standardize tangible property tax rates in every municipality so that tangible personal property tax rates are no more than twice the residential property tax rate
- Standardize commercial property tax rates in every municipality so that commercial personal property tax rates are no more than 50 percent greater than the residential property tax rate
- Move toward a state determined motor vehicle excise tax rate of \$25 per \$1,000 of assessed value or increase the current state mandated motor vehicle excise tax exemption amount to \$6,000

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## Governor's Tax Reform Proposals: Legislative Action 2009 Session

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- Governor Carcieri included several of the proposals in his 2010 Budget although none of the Workgroup's property tax proposals were among them
- The General Assembly accepted the proposal to change the definition of eligible employee for purposes of qualifying for the Jobs Development Act rate reduction
- No other corporate income tax proposals were approved by the General Assembly

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## Governor's Tax Reform Proposals: Legislative Action 2009 Session

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- ❑ The General Assembly rejected all aspects of the Governor's personal income tax proposals except the taxation of all capital gains as ordinary income effective January 1, 2010
  
- ❑ The General Assembly did increase the estate and transfer tax exemption amount to \$850,000 effective January 1, 2010 and indexed this amount for inflation beginning on January 1, 2011

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## **The Personal Income Tax Reform of 2010**

## The Governor's Net Receipts Tax Reform Proposal

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- The Governor directed the Department of Revenue to analyze the establishment of a net receipts tax in conjunction with:
  - Reducing the corporate income tax rate from 9.0 percent to 4.5 percent
  - Reducing the corporate minimum tax from \$500 to \$250
  - Reducing personal income tax rates by 25.0 percent across the board
  - Eliminating the estate and transfer tax

## The Governor's Net Receipts Tax Reform Proposal

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- The Governor shares the Net Receipts Tax reform analysis with the Speaker of the House, the Senate President, the House and Senate Majority Leaders, and the Chairmen of the House and Senate Committees on Finance
- Although the legislative leaders did not agree with the Governor's Net Receipts Tax Reform, they did conclude that reform of the personal income tax system was needed

## The Personal Income Tax Reform of 2010

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- The Senate Finance Committee Chair led the way for the Personal Income Tax Reform of 2010 (which is effective for TY 2011 and thereafter)
- The starting point of the Personal Income Tax Reform of 2010 was the Tax Policy Strategy Workgroup's personal income tax proposal
- Several members of the Governor's Workgroup lobbied the General Assembly leadership to seriously consider personal income tax reform

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## Changes to the Workgroup's Personal Income Tax Reform Proposal

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- Leave the Earned Income Tax Credit as it is in current law
- Increase the personal and dependent exemption amount to \$3,500
- Reduce the taxable income brackets from four to three by expanding the second bracket to up to \$125,000 and eliminating the third bracket

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## Changes to the Workgroup's Personal Income Tax Reform Proposal

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- Increase the marginal tax rates to 3.75, 4.75, and 5.99 percent
- Expand the number of credits that can be used to include:
  - 25.0 percent of the federal Child and Dependent Care Credit,
  - the Motion Picture Production Tax Credit, and
  - the Historic Preservation Investment Tax Credit

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## Changes to the Workgroup's Personal Income Tax Reform Proposal

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- Phased out the standard deduction and personal and dependent exemption amounts by 20.0 percent for every \$5,000 increase in Rhode Island Adjusted Gross Income
  - \$175K < RI AGI < \$180K: No phase out
  - \$180K ≤ RI AGI < \$185K: 20.0 pct phase out
  - \$185K ≤ RI AGI < \$190K: 40.0 pct phase out
  - \$190K ≤ RI AGI < \$195K: 60.0 pct phase out
  - \$195K ≤ RI AGI < \$200K: 80.0 pct phase out
  - RI AGI ≥ \$200K: 100.0 pct phase out

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## Constraints on the Personal Income Tax Reform

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- "Middle" Class taxpayers could not face a tax increase on average
  - Simulation results indicated that, on average, only taxpayers with Federal AGIs > \$175,000 would pay more in income taxes
  - Simulation results showed that 297,489 taxpayers would have a tax decrease and 96,461 would have a tax increase
  - The average [median] tax increase was \$653.84 [\$230.00] while the average [median] tax increase was \$225.56 [\$77.00]

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## Constraints on the Personal Income Tax Reform

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- The top marginal tax rate could not be greater than the TY 2010 alternative flat tax rate of 6.0 percent
  - The top marginal tax rate was set at 5.99 percent
- The budget impact of the personal income tax reform had to be revenue neutral
  - The impact on total revenues collected under the new personal income tax system vs. the existing personal income tax system was estimated to be a loss of \$284,068 or 0.0 percent

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## Passage of the Personal Income Tax Reform of 2010

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- The legislation reforming Rhode Island's personal income tax system was introduced in concurrence in the House and Senate Finance Committees on June 4, 2010 and were passed unanimously by both
- The concurrent bills were debated in the House and Senate on June 4, 2010 and passed 71-0 and 35-0 respectively
- The Governor signed the bills into law on June 9, 2010

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# Thank You



Paul L. Dion, Ph.D.  
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Rhode Island Department of Revenue  
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